

Message Text

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ACTION EB-08

INFO OCT-01 AF-08 ARA-06 EA-07 EUR-12 NEA-10 IO-13 ISO-00
ERDA-05 AID-05 CEA-01 CIAE-00 CIEP-01 COME-00 DODE-00
FEAE-00 FPC-01 H-01 INR-07 INT-05 L-03 NSAE-00 NSC-05
OMB-01 PM-04 USIA-06 OES-06 SP-02 SS-15 STR-04
TRSE-00 ACDA-07 PA-01 PRS-01 /146 W
-----311727Z 125120 /45

R 311646Z JAN 77

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 0076

INFO USMISSION OECD PARIS

USMISSION EC BRUSSELS

AMEMBASSY BONN

AMEMBASSY PARIS

AMEMBASSY ROME

AMEMBASSY TOKYO

AMEMBASSY OTTAWA

AMEMBASSY CARACAS

AMEMBASSY JIDDA

AMEMBASSY ABU DHABI

AMEMBASSY TEHRAN

AMEMBASSY VIENNA

AMEMBASSY KUWAIT

AMCONSUL DHAHRAN

USINT BAGHDAD

C O N F I D E N T I A L SECTION 01 OF 02 LONDON 01706

E.O. 11652: XGDS-1

TAGS: ENRG, UK

SUBJECT: VIEWS OF UK ENERGY DEPARTMENT OFFICIALS ON
OPEC PRICING

REF: LONDON 1073

1. SUMMARY. UK ENERGY DEPARTMENT OFFICIALS SEE THE 5
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PRICE INCREASE EFFORT AS LIKELY TO FAIL. THEY ALSO
THINK THAT SAUDI ARABIA BY FOLLOWING THIS LINE HAS
CREATED AN EMBARRASSING SITUATION. THEY VIEW THE
SAUDI ARABIAN POLICY AS INCONSISTENT WITH WHAT SAUDI
ARABIA HAS BEEN PREACHING: CONSERVATIVE USE OF OIL
RESOURCES. FINALLY THEY FEEL THAT LOWER THAN TYPICAL
PRICE INCREASES WOULD, TAKING INTO ACCOUNT LONG TERM

OIL DEMAND DEVELOPMENTS, RESULT IN AN OIL GAP OR A SHARP INCREASE IN OIL PRICES IN THE LONG RUN. END SUMMARY

2. DURING A DISCUSSION WITH FEA ASSISTANT ADMINISTRATOR MALIN AND AN EMBASSY OFFICER, DEPARTMENT OF ENERGY OFFICIALS (WILMOTT, LUCAS AND CURTIS) TALKED FRANKLY AND OPENLY ABOUT HOW THEY SAW THE TWO TIER PRICE SITUATION. WE CAN ASSUME THAT THEIR VIEWS ARE TYPICAL OF THE DEPARTMENT OF ENERGY ALTHOUGH H.M. GOVERNMENT HAS CONTINUED CAREFULLY TO AVOID PUBLIC COMMENT ON THE SITUATION.

3. ONE OF THE OFFICIALS OFFERED A RULE OF THUMB THAT IF WORLD IMPORT DEMAND IS BELOW 30 MILLION BARRELS PER DAY THE 5 LINE WILL WIN; IF IT RISES ABOVE THAT MARK THE TEN PERCENTERS WILL WIN. AFTER THE STOCK BUILDING OF THE LAST QUARTER OF 1976 IT WOULD BE NATURAL FOR DEMAND TO FALL DURING THE FIRST QUARTER OF 77. THIS DROP OFF IS TAKING PLACE AND IS BEING ACCOMPANIED BY A DEFINITE SHIFT AWAY FROM IRANIAN, KUWAITI AND POSSIBLY IRAQI HEAVY CRUDE TO SAUDI CRUDE. (HOWEVER, THE INCREASED DEMAND IN THE U.S. DUE TO COLD WEATHER (1 MILLION B/D) AND PROSPECTIVE US SECURITY STOCKBUILDING RUN COUNTER TO THE SAUDI TACTICS.) THE SECOND AND PERHAPS THE THIRD QUARTERS OF THE YEAR WILL BE THE REAL TESTING PERIOD. BY THAT TIME STOCKS WILL HAVE BEEN WORKED OFF AND UNDERLYING DEMAND MAY INCREASE. ON THE OTHER HAND, SAUDI PRODUCTION WILL NOT HAVE RISEN
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ENOUGH TO MATCH THIS INCREASED DEMAND. BY LATE IN 1977 OR EARLY 1978 THE SITUATION MAY CHANGE WITH INCREASED SAUDI PRODUCTION, AND SUPPLIES FROM OTHER AREAS SUCH AS ALASKA AND THE NORTH SEA BECOMING AVAILABLE IN GREATER QUANTITIES, BUT THE REAL TESTING PERIOD WILL BE WHAT HAPPENS IN THE PERIOD UP TO THE JULY OPEC MEETING. IF THE SHAH CAN KEEP HIS NERVE DURING THE DIFFICULT FIRST QUARTER THESE BRITISH OFFICIALS THINK THAT THE TIDE WILL TURN THEREAFTER IN APRIL THROUGH JULY, AND LEAVE SAUDI ARABIA IN AN UNSUSTAINABLE POSITION. THEY THINK THE LIKLIEST AND BEST OUTCOME AT THAT POINT WILL BE AN AGREEMENT TO A 10 INCREASE WITH SAUDI ARABIA MOVING ITS PRICES UP AND THE OTHER OPEC COUNTRIES ABANDONING THE IDEA OF A 5 ADDITIONAL INCREASE.

4. THE OFFICIALS SAID THAT THEY HELD JULY TO BE THE KEY POINT BECAUSE THEY DID NOT BELIEVE THAT SAUDI ARABIA WOULD BE WILLING TO CONTINUE INCREASING ITS

PRODUCT AT A RAPID PACE INDEFINITELY. THEY NOTED THAT EVEN THE INCREASES NOW UNDERWAY, AND THE PRICING POLICY NOW BEING FOLLOWED BY SAUDI ARABIA, WERE INCONSISTENT WITH THE LONG TERM POLICY SAUDI ARABIA HAS PREACHED IN CIEC AND ELSEWHERE, OF CONSERVING OIL.

5. THEY FELT THAT SAUDI ARABIA HAD PUT ITSELF IN AN EMBARRASSING POSITION, ONE WHICH MIGHT PROVE EMBARRAS-

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C O N F I D E N T I A L SECTION 02 OF 02 LONDON 01706

SING FOR THE CONSUMER COUNTRIES AS WELL. THEY READ

SAUDI ARABIA'S DESIRES OR GOALS AS THREE-FOLD: ACHIEVE LEADERSHIP OF OPEC; OBTAIN PRESERVATION OF THE VALUE SAUDI ASSETS; ACHIEVE AN IMPROVEMENT IN THE MIDDLE EAST POLITICAL SITUATION. A SUBSIDIARY GOAL IS TO SCORE SOME POINTS FOR THE SOUTH IN CIEC. THEIR READING WAS CONFIDENTIAL

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THAT THE PRACTICAL BASIS FOR SAUDI LEADERSHIP OF OPEC - GETTING OTHERS TO FOLLOW THE SAUDI PRICE LEAD - WOULD NOT BE ACHIEVED OVER THE COMING MONTHS. OTHER SAUDI AIMS WERE EQUALLY DIFFICULT OF ACHIEVEMENT. ON THE OTHER HAND IF SAUDI ARABIA WENT TO THE OPEC MEETING HAVING SUFFERED DISAPPOINTMENT ON ALL FRONTS THESE OFFICIALS WOULD NOT EXCLUDE A COMPLETE REVERSAL OF POSITION BY SAUDI ARABIA, FROM BEING ON THE LOW PRICE SIDE TO ADVOCATING STILL HIGHER PRICES THAN IRAN, FOR EXAMPLE. THIS POTENTIAL FOR A RADICAL SHIFT IN THE SAUDI POSITION WOULD MAKE THE DEVELOPED COUNTRIES VULNERABLE IN CIEC. TO SAVE SAUDI ARABIA'S FACE AND TO AVOID SUCH A WORST CASE SOMETHING MIGHT HAVE TO BE GIVEN TO THE LDC'S IN CIEC WHICH SAUDI ARABIA COULD CLAIM AS A VICTORY.

6. FINALLY THE ENERGY DEPARTMENT OFFICIALS WONDERED IF SAUDI ARABIA WOULD BE DOING THE CONSUMER COUNTRIES A LONG TERM FAVOR EVEN IF IT SUCCEEDED IN ITS PRICE STRATEGY. THEY FELT THAT OVER THE NEXT TEN YEARS OIL PRICES WOULD HAVE TO RISE AT A NOMINAL RATE OF ABOUT 10 ANNUALLY (4-5 IN REAL TERMS) TO PRODUCE A DEMAND SUPPLY EQUILIBRIUM IN THE MID-1980'S. UP TO NOW SAUDI ARABIA HAD BEEN EITHER ADVOCATING OR GOING ALONG WITH SUCH PRICE DEVELOPMENTS. ITS CURRENT POLICY WAS AN ABERRATION. IF OIL PRICES ROSE TOO SLOWLY FOR A FEW YEARS, CONSUMER COUNTRIES WOULD LOSE THE INCENTIVE TO DEVELOP ALTERNATIVE SUPPLIES OR CONSERVE OIL MORE EFFECTIVELY; IN ANY EVENT THE END RESULT WOULD BE THE NEED FOR ANOTHER BIG JUMP IN OIL PRICES TO RATION DEMAND TO MATCH SUPPLY.

7. THE ENERGY DEPARTMENT OFFICIALS ALSO COMMENTED BRIEFLY ON THE BRITISH GOVERNMENT'S INTERNAL OIL PRICING POLICY. THE UK IS NOT NOW GOING IN FOR ANY EQUILIZATION SCHEMES. PRICE CEILINGS FOR PETROLEUM PRODUCTS
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WILL BE ADJUSTED ACCORDING TO THE COSTS OF THE COMPANIES

INVOLVED, WHICH MEANS THAT THE ARAMCO COMPANIES WILL BE ALLOWED LOWER CEILINGS THAN BP FOR EXAMPLE. AS FOR NORTH SEA OIL, THE OUTLOOK IS FOR NORTH SEA OIL TO FOLLOW THE 10 INCREASE IN LIGHT OIL PRICES THAT HAS ALREADY TAKEN PLACE. THEY SAID THAT THE MAIN SPECIFIC DETERMINANT OF THE PRICE OF NORTH SEA OIL IS THE PRICE OF NIGERIAN OIL.

ARMSTRONG.

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